Inequality is not fate

Joseph E. Stiglitz
Milan
May 12, 2017
There has been growing inequality within most countries of the world

- Is this growth a result of forces of nature—the basic laws of economics?
  - Or is it result of “the laws of man”—what we ourselves are doing?
- Is it the result of the basic workings of the market?
  - An inevitable, if unpleasant, side effect?
- Or is it the result of how we have structured markets, of how we have changed the rules of the game in our market economy, in some cases undermining the market economy
  - And of the way we have structured globalization—the evolving geo-political situation
Explaining the growing inequality

• Is it because we have not done enough to *counter* the forces of nature?

• Is it because, rather than trying to stand against the tide, we have reinforced the effects of nature, of the laws of economics?

• And is it because the way our global governance has worked against ordinary citizens around the world?
The central theses of this lecture

• The growing inequality is largely the result of the “laws of man”
• It is a result of how we have structured the market economy—more precisely, of how we have *restructured* it in the last third of a century
• Inequality has been a *choice*
  • In our democracy, a choice made through our political system
  • But our political system has often exhibited a “democratic deficit”
• What we have done has resulted not only in more inequality, but in lower growth, more instability, and overall poorer economic performance
• There are reforms—in our economy, in our society, in our political institutions—which can help create a shared prosperity
I. A brief description of what has been happening

- More money at the top
- More people in poverty
- The evisceration of the middle

- US provides worst example
- But countries following US economic model are moving in the same direction
US: bottom 90% have seen little increase in income over last third of a century

Source: World Wealth and Income Database
Europe: less increase in inequality in some countries than in others

Source: World Wealth and Income Database
Italy: increase in inequality has been less extreme

Source: World Wealth and Income Database
Income share of the richest 1%

CEO pay provides “worst” example

• In US, risen to more than 300 times that of the average worker

• Bankers walked off with major bonuses, even as they brought their firms—and the global economy—to the brink of ruin
  • Undermining “standard” theory that compensation in a market economy is based on social contributions (“marginal productivity”)
Stagnation: U.S. median household income (constant 2015 US$)

1998: $58,301

2015: $56,516

Source: U.S. Census Bureau

Note: Data is adjusted for the methodological change of 2013.
US: Median income of a full time male worker is at the level that it was more than 4 decades ago (constant 2015 $)

Source: U.S. Census Bureau  
Note: Data is adjusted for the methodological change of 2013.
Median household income in Europe

Disposable Median Net Income


Source: Eurostat
Median household income in Italy

Disposable Median Net Income

Source: Eurostat
US: Real wages at the bottom are at the level that they were roughly sixty years ago

Europe: Real Minimum Wages

Source: Eurostat.
Multiple aspects of inequality

• Voice
  • Attempts in US at disenfranchisement

• Access to justice
  • Mass incarceration
  • Mass evictions

• Wealth inequality greater than income inequality
The Walton Family and The Koch Brothers’ net worth = $230 billion

That’s the net worth of 150 million Americans or 44% of the country.
Health inequalities

A Rising Toll

New research shows the increasing mortality rate among white Americans spans age groups and is most acute among the less-educated.

White deaths are rising...
Mortality rate by race, ages 50-54

...among all age groups of less-educated whites...
Mortality rate for whites with high school education or less, by age

...in contrast to elsewhere...
Mortality rate for all causes, ages 45-54

...due in part to increases in 'deaths of despair'.
Mortality rate due to alcohol, drugs and suicide, ages 50-54

Source: Anne Case and Angus Deaton of Princeton University, charts published in Wall Street Journal.
Most invidious aspect: inequality in opportunity

- America among the countries with the least opportunity—in spite of the notion of the country being the land of opportunity (American dream)
  - Life prospects of a young American more dependent on the income and education of his parents than in other advanced countries

- Not a surprise: systematic relationship between inequality in incomes (outcomes) and inequality of opportunity
  - Other countries with high levels of inequality also have low levels of equality of opportunity
Income inequality and earnings mobility

Global inequality

- Almost all advanced countries have seen increased inequality in last 30 years
  - But some have seen much greater increase than others
  - Cannot explain these differences by “economic laws”
- The trend around the world is somewhat mixed, but remains a concern almost everywhere
  - Some countries (especially in Latin America) have even managed to reduce inequality
- **Inequality is a choice**
Global inequality: income growth by percentile

Source: Branko Milanovic.
Globally, matters are even worse

Oxfam reports on wealth concentration at the top: how many of the richest people have as much wealth as bottom 50% (bottom 3.6 billion!)

- In 2014: 85
- In 2017: just 8 men

Big winners during last quarter century

- Global 1% and global middle class (middle class in China and India)

Big losers during last quarter century (not sharing in gains)

- Those at the bottom and the middle class in advanced countries
II. Major changes in understandings of inequality

1. Trickle down economics doesn’t work

2. Large differences in outcomes/opportunities among advanced countries
   • Suggesting that it is policies, not inexorable economic forces that are at play

3. Economies with less inequality and less inequality of opportunity perform better
   • Many reasons for this
     • Lack of opportunity means that we are wasting most valuable resource
     • Erosion of trust—which is important for the functioning of the economy
   • In last few years, this view has become “mainstream”
4. Kuznet’s law—that while in the initial stage of development there is an increase in inequality but thereafter, there will be a decrease—has been repealed.
III. Explaining change

• Key question
  • Was period after WWII, the “golden age of capitalism,” an aberration, the result of the social cohesion brought on by the war?
    • With the economy now returning to the natural state of capitalism?
  • Or is the increase in inequality after 1980 a result of a change in policies and certain changes in the structure of our society?
  • Evidence that something “big” happened around 1980
US: Disconnect Between Productivity and a Typical Worker’s Compensation, 1948-2015

Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

Source: EPI analysis of data from the BEA and BLS (see technical appendix of Understanding the Historic Divergence Between Productivity and a Typical Worker’s Pay for more detailed information)

Economic Policy Institute
Europe: Disconnect in Productivity and Compensation

Source: Eurostat.
Multiple explanations

- Beginning about a third of a century ago, we began a process of rewriting the rules
  - Lowering taxes and deregulation was supposed to increase growth and make everyone better off
  - In fact, only the very top was better off—incomes of the rest stagnated, performance of the economy as a whole slowed
- Markets don’t exist in a vacuum—government sets rules of game, and how it sets rules and policies and how it enforces them affects efficiency and distribution

More generally: increasing importance of rents

- Associated with changes in technology, demand and changes in the rules
  - Greater urbanization (land rents)
  - Increased importance of network effects—leading to market power in key new sectors
  - Increased importance of local services—with local monopoly power
  - Weakening bargaining power of unions
  - Weakened enforcement of anti-trust rules
  - Globalization (as its been managed)
  - Changes in corporate governance
Rent seeking within corporations

• Managers have used their managerial discretion to seize a larger fraction of corporate rents
  • Sometimes in the name of “incentive pay”
  • But incentives have actually been perverse
  • Increase in executive pay may come at the expense of investment in people, technology, plant and equipment—i.e. long run performance of enterprise
IV. Solutions

• No magic bullet
• But there are a range of actions
  • Labor market practices
  • Social movements
  • Politics and institutions
Labor market practices and institutions will have to change

- Many implications of the end of lifelong employment
  - Diminished role of employer in providing social protections
    - individuals on their own can’t manage many of the risks they face
    - Increased role of state—flexisecurity
  - Diminished role of employer in providing training
    - Increased role of state and of individual
    - New technologies (MOOCS) provide new opportunities in many areas
- Rethinking role of formal education
  - Learning how to learn—for life long learning
  - Greater focus on creativity
Real wealth of nations--Abilities and creativity of individuals

- *Creating a Learning Society* and a Learning Economy
  - Agenda in Netherland
  - Structuring interactions
    - clusters
  - Facilitating transmission of ideas
  - In some cases encouraging labor mobility
    - Opposite of what was attempted in Silicon Valley

Structure of labor bargaining may change

- Larger percentage of private employment concentrated in small enterprises or self-employment (gig economy)
- Government may need to take more active role in defining what is an employment relationship and ensuring minimal standards (UBER)
Social attitudes may need to change

• Including those associated with gender
• Skills and attitudes valued in market place increasingly related to gender
  • College completion
  • Service related jobs
• Yet wage discrimination persists
• Difficulties especially evident in US in middle age men without college degree—and reflected in health statistics
Social movements

• The public good is a public good—everyone benefits from a well managed society
• In general, there will be an undersupply of public goods—basic insight of modern economics
• Another basic insight: the key importance of collective action, especially in modern economy
  • Importance of environmental externalities
  • Importance of education
  • Importance of knowledge
• Social movement part of solution to collective action
New technologies have had mixed effects

- Facilitated ability to organize collective action
- But also facilitated ability of those working against public interest to undermine collective well-being
  - Spreading fake-news
  - Undermining foundations of our society—our views of truth and trust
  - Undermining basis of knowledge, the scientific method, core to the success of our economy and society since the enlightenment
Institutions—and the role of government

- Inequality has been increased by the rewriting of the rules during the last third of a century, and the failure to write new rules reflecting changes in the economy and society.
- We now need to rewrite the rules once again, for the twentieth century.
  - Including the rules that define how our institutions work
    - The central bank, our education system, family law
  - Rules that define how our market work
    - Anti-trust, labor law, corporate governance, finance and banking
    - Intellectual property, bankruptcy, rights to privacy, rights to information
Most importantly—the rules of democracy

• That affect ability and desire to participate meaningfully in political decision making
• Again, technology can have mixed effects
• Key battles in US are over disenfranchisement and disempowerment
  • Deliberate attempt to discourage certain segments of population from voting, making a mockery of the democratic process
  • Deliberate attempts to distort information received by certain segments of population
  • Disproportionate role of money in politics
• No simple answer—on going debate
• But there are ways to make political system more democratic and more responsive
• Critical if we are to achieve shared prosperity
V. Severe Economic and Political Consequences

• Inequality itself led to more instability and poorer economic performance
• Economic inequality led to political inequality
• Leading to even worse “rules of the game”—favoring the 1%.

• The discrepancy between promises and what has been delivered too has had consequences
  • Citizens know that the “establishment” has either lied to them, or been totally incompetent
  • They feel (rightly) that the economic system is rigged
  • They saw how the bankers were saved in the economic crisis—but not the rest: they have lost trust in their government and the fairness of our economic and political system
Even worse moral and societal consequences

• Single minded focus on profits and financial incentives has changed who we are
  • Preferences and beliefs are endogenous
  • Society has become more selfish
  • Moral turpitude pervasive—from the bankers to the auto industry
VI. Key message of this talk: There are alternatives

- Alternative ways of organizing our economy and society
- Alternative institutional arrangements, such as cooperatives and not-for-profits
- Institutional innovations
- Policies which give greater scope for new institutions and encourage better performance of existing institutions
- These “reforms” likely to reduce inequality, and even lead to faster overall growth
  - Partly because of a growth in trust and loyalty—important for economic performance
    - Lower turnover, greater effort
    - More shared prosperity
Alternatives to for-profit model based on selfishness

• The best performing institutions in the US are its not-for-profit universities
  • Among the worst performing are its for-profit universities

• Micro-credit schemes in Bangladesh based on non-profit cooperative model have brought tens of millions out of poverty
  • Micro-credit scheme in India based on for-profit model re-invented old-style money lender, and became India’s sub-prime lender

• Profit-sharing has become central in 2016 US presidential campaign
  • Based on wealth of evidence that firms with profit sharing actually perform better, especially for workers and especially over the business cycle
Broader need for collective action

• But there is a broader need for collective action to ensure middle-class living standards are attainable for most citizens, and that our economy works for all
  • Regulations to prevent abuses
  • The Entrepreneurial State to promote innovation

• There is room for innovation both in the policies that deliver these public goods and services and the governance structures through which they are delivered
We have choices

• There are alternatives to the current system
  • Even if the advocates of the system suggest there are not
  • And seem to suggest that, at most, we need just minor tweaks on the system

• The problems are deep and fundamental

• Some of these alternatives have proven their value over decades

• We should learn from these experiences

• Many of changes made in the rules over the past third of a century have made matters worse
  • And we have not kept up with changes presented by changes in technology, by globalization, and by changing societal attitudes

• We can reshape our economy and construct a world where the economy performs better for all, or at least for the vast majority